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JAN 19 1956

MEMORANDUM FOR: Director of Central Intelligence

SUBJECT : Taxability of Allowance Payments to Contract Agents

REFERENCE : Memorandum from Office of the General Counsel to Director of Personnel, dated 23 December 1955, subject, Grant of Allowance Payments to Independent Contractors (Attached as Tab A)

PROBLEM

To determine the CIA position with regard to furnishing information to the individuals concerned and Internal Revenue Service of the taxable income for independent contractor personnel for prior tax years including 1955.

FACTS

1. As of the current date, there are approximately 300 U.S. National Contract Agents operating in approximately 271 separate projects. The contract, in approximately 250 of these cases, provides for the payment of allowances, in one form or another, ranging in amounts up to \$6,865 per annum.
2. In the minds of these contract agents, and most responsible Agency employees, the allowances granted in the contracts were assumed to be similar in nature to those granted employees. Per reference memorandum from the General Counsel, this similarity cannot be assumed. However, since most, if not all, contract agents assumed these allowances to be tax free (in many cases they have been specifically so advised by various responsible Agency personnel), the allowances have not been reported as taxable income in the individuals tax return for prior years.
3. In addition to the problem created by the additional tax liability which would be imposed, there is, from the Agency standpoint, a far more serious question of getting the proper information and advice to these persons under their varying cover circumstances. In a similar manner, problems would develop with respect to handling of the annual income tax returns, since in many cases the contract agents will have filed returns based on their own determination of taxable income received.
4. The Finance Division as a normal procedure advises all contract agents through appropriate channels of the amounts of taxable income

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paid them by the Agency. Where the individuals file their returns through the [] or as otherwise required, Finance Division also certifies these amounts of taxable income to Internal Revenue Service through the []

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5. Arrangements have been made whereby two representatives from the Office of the General Counsel are proceeding abroad in the near future to assist the various field stations with income tax problems with particular emphasis on the difficult cases resulting from security considerations. In addition, the legal representative from the Far East is presently in Washington on TDY to be briefed for the same type of assistance when he returns to the area. Their effectiveness will be materially increased if the determinations required in this situation are made prior to their departure for the field.

DISCUSSION

1. For reference, the tax status of allowance payments to independent contractor types is clear under the internal revenue code. It is also true that the provisions of the Internal Revenue Code place the fundamental responsibility of reporting and paying proper tax on the individual concerned. This is a personal liability over which the Agency has no authority. It is equally true that in the existing situation most persons concerned, including the contract agents as well as responsible Staff personnel, believed, contrary to law, that the allowances in question were tax free.

2. As pointed out in reference, the basic problem arises in view of the legal nature of the status of an independent contractor and the fact that the tax free status of allowances specifically applies to U.S. Government employees. It is possible that certain individuals presently in the contract agent category, or other independent contractor-type categories, are, in fact, employees of the Agency. In these cases where a proper determination is made that the individuals should be considered employees, the tax problem automatically solves itself.

3. The Finance Division has advised that if the Agency were to decide to certify allowance payments to independent contractors for 1955 as taxable income, it would be impossible to develop the information through the Area Divisions, which is necessary for determination of the proper taxable income figures prior to 15 April 1956. Further, the application of this ruling at this time without ample notice and explanation, would undoubtedly result in the resignation of a number of contract agents, and would create serious operational problems at the field station level. The loss of efficiency and lowering of morale resulting from this reversal of previous commitments by the Agency to most of these agents is difficult to estimate, but is considered serious.

4. Although CIA has wide latitude and broad authorities, there is an obligation under the law for the Agency to furnish accurate

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information, both to the individuals concerned and to Internal Revenue Service where required. In addition, there are the practical aspects of our relationship with Internal Revenue where over the years they have done everything possible to assist the Agency in handling in a secure fashion various tax matters which have arisen. They, at the present time, place heavy reliance on the principal item involved, i.e., the Agency's statement of taxable income paid.

5. There are three principal alternatives open to CIA: a. the Agency, wherever required to furnish figures, could for prior and future years attempt to develop and certify them completely accurately in accord with the law; b. the Agency could continue its existing practices of not furnishing figures pertaining to amounts paid as allowances through the tax year of 1955 and then adjust its practices in an orderly fashion during 1956; c. the Agency could attempt to develop and report accurately the figures for taxable year 1955 on a belated basis, and simply not review any previous statements made. In combination with any one of these approaches, the Agency could authorize increases of compensation to offset the increased tax imposed upon the individuals concerned.

CONCLUSIONS

1. At this time, to attempt to notify all individuals concerned of the correct tax status of allowances and to furnish them the proper figures would cause a serious security problem, would lower morale considerably and would create an extremely serious administrative burden on the area divisions as well as the Finance Division and as to both the burden would fall on field stations and Headquarters.

3. With full realization of the factors on both sides of this question, it is believed that, on balance, the Agency should continue its existing practices of not reporting allowances as taxable income for all prior years, including 1955.

4. For 1956 and future years, it is planned that: a. new contracts will be written to reflect properly the taxability of additional payments for overseas service; b. existing contracts will be amended as necessary to clear up any possible misunderstanding or misinterpretation in this regard, and where appropriate, to provide additional income to offset the additional tax liability; and c. to provide in contracts the basis for determination of the dollar value of quarters which are furnished contract agents in kind.

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RECOMMENDATION

It is recommended that the Director of Central Intelligence approve continuation of the current Agency practice of not reporting, either to the individuals concerned or the Internal Revenue Service, any amounts paid to independent contractors (includes contract agents) in the nature of allowances, including allowances paid in kind, for all prior tax years including 1955.

(Signed) FRANK G. WISNER

FRANK G. WISNER
Deputy Director (Plans)

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CONCUR:

(SIGNED)

SSA-DD/S

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Subject to oral comments on the legal question } /s/

for OGC

OGC

/s/ E. R. Saunders

Comptroller

/s/

Acting Director of Personnel

*In view of the fact that this is an Administrative matter, the recommendation in the final paragraph above is approved without reference to the Director. The Office of Personnel will submit a monthly report to DD/S as to progress made until we are in a position to say we are current.

* /s/ L. K. White

Deputy Director (Support)

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/s/

L. K. WHITE
Deputy Director
(Support)

The recommendation in the final paragraph above is approved.

27 Jan 56

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